

# *Insurance Scoring in New Jersey*

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New Jersey recently approved the use of insurance scoring for Mercury Indemnity Company of America, a subsidiary of Mercury General Insurance Group. This is the first time insurance scoring has been used in rating New Jersey private passenger auto insurance.

Mercury's New Jersey scoring method includes several key restrictions designed to protect consumers. Mercury's model considers exceptions for the following life-altering events:

- **Death of spouse or close family member**
- **Divorce**
- **Identity theft**
- **Major illness or injury**
- **Recent loss of a job**

Mercury's method of evaluating financial responsibility is designed to look at a driver's long-term track record of handling what money he or she has; low- and moderate-income drivers do not automatically fare worse than high-income drivers. Mercury looks at a person's bill-paying practices over a seven-year period, with greater weight given to the last three years.

Regulatory staff at the Department of Banking and Insurance worked with Mercury to ensure that:

- **Drivers without recent financial responsibility scores will be treated neutrally. They will be assigned to a tier with better than standard rates.**
- **Drivers with poor financial responsibility scores who have a clean driving record for the previous three years will not be placed in substandard tiers.**
- **Drivers with outstanding financial responsibility scores who seek to buy lower coverage limits can achieve more favorable tier placement. This will bring savings to drivers of modest means who have fewer assets to protect.**

***For more information,  
call (800) 446-SHOP***

***[www.njdobi.org](http://www.njdobi.org)***



New Jersey  
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# *Insurance Scoring*



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## What Consumers Need to Know



# What is Insurance Scoring?

The business of insurance is all about weighing risk. In deciding whether to provide or renew coverage for your home or car, an insurer has to make some educated guesses about a number of things. These educated guesses are based on statistics and probability. How likely is it that you'll be involved in an auto accident? How likely is it that your house will catch fire? In order to honor its obligations to all its policyholders, the insurer has to be as certain as possible that it has enough monetary reserves to pay all the claims that are likely to be presented to it in a given period. Among other things, that means charging people for insurance coverage according to the risk they represent. It also means refusing to insure some people because they pose an unacceptably high risk of loss to the company and thus to the other policyholders.

Some insurers use a tool called an **insurance score** to predict future insurance losses. An insurance score is developed from a mathematical model that weighs and measures credit information such as the number of collections, bankruptcies, outstanding debt, length of credit history, types of credit in use and the number of new applications for credit. These factors identify credit management patterns that have been proven to correlate with the probability of an insurance loss.

An insurance score is based solely on information contained in consumer credit reports from a major credit bureau, such as Equifax, Experian and TransUnion. According to company data, a **high score** indicates that an individual is a member of a group

that is less likely to have future losses. A **low score** indicates that an individual is a member of a group that is more likely to have future losses. In other words, the lower your insurance score, the more likely you are to file a claim. Data also reveals a link between lower scores and higher claim amounts. While a high insurance score does not by itself mean that a policyholder is a good and responsible driver, research shows that those with high insurance scores generally file fewer and less expensive claims than other groups. As with all classification systems, individual performance may vary from that of the group. Assigning individuals to a group is a common practice in personal lines underwriting and pricing.

Nationally, most companies use insurance scoring as just one of several factors in the underwriting decision. An insurance score is used in conjunction with motor vehicle records, loss reports, and application information to determine your insurance risk at a particular point in time.

Insurance companies, banks and department stores have been using your credit information for many years to help determine your level of risk before selling or renewing homeowner's policies, issuing a loan or extending credit. Employers routinely order credit reports for new and prospective employees. In the auto insurance market, insurance scoring is used in more than 40 states, and by well-known companies such as Progressive that do not currently operate in New Jersey. Like any other underwriting factor, some drivers will benefit and some will not.

***An insurance score is used in conjunction with motor vehicle records, loss reports, and application information to determine your insurance risk at a particular point in time.***

## How is it used?

It is important to understand that an **insurance score is not a credit report or a financial credit score**. An insurance score is a number assigned to you based on information gathered from a consumer credit report issued by a major credit bureau. Generally, however, this score is not generated by the insurance company itself, but rather by a contracted vendor hired by the insurance company. Therefore, **in most cases, the insurance company does not see your actual credit report**. Generally, when an application is submitted to the insurance company, the insurer sends an inquiry to their contracted vendor. This vendor contacts one of the major credit bureaus for specific information about the applicant's credit history. The vendor then enters these specific credit attributes into a model and generates a score. This score, and only the score, is then reported to the insurance company. Generally, the higher the score, the more financially responsible the consumer.

Nationally, insurance companies use insurance scoring in two ways:

- **Underwriting — Deciding whether to issue you a new policy or to renew your existing policy.**
- **Rating — Deciding what price to charge you for your insurance by placing you into a specific rating “tier” or level.**

Insurers typically use credit information with other more traditional rating factors, such as motor vehicle records and claims history. Nationally, the weight of various credit factors can vary from company to company, so if you feel your rate is too high, shop around.



### Why are insurance companies using credit-based insurance scores?

Insurance companies have found that an insurance score is an accurate predictor of a consumer's likelihood to file future claims. Tests were conducted to compare insurance scores against the claims history of policyholders. They found that the scores do predict the likelihood of claims.

## Where do insurance scores come from?

Scores are based on information from consumer credit reports that insurers or statistical modelers get from the three major credit bureaus: Equifax, Experian (formerly known as TRW) and TransUnion. Another company, Fair Isaac, provides the majority of the statistical models used to calculate insurance scores. ChoicePoint also provides statistical modeling, as well as underwriting claims information services to help insurance companies assess insurability.

## How are insurance scores computed?

Generally, an insurer sends an inquiry to one of several vendors. The vendor then conducts a process in which specific credit report attributes are put into the model (for that individual carrier) which then produces a score. The model assigns values to certain attributes or situations that reduce or increase the score. Negative attributes are assigned for situations such as bills which are paid late or go unpaid, high balances maintained on credit cards, collection agency entries, etc. The more negative attributes, the lower the score. The score is returned to the inquiring insurer, and the insurer can then use the score in its decision-making processes.



## Factors that affect your credit

Following is a list of common factors that affect your credit. (Note: Not all of these factors are used in insurance scoring.)

- **Major negative items** — Bankruptcy, collections, foreclosures, liens, etc.
- **Past payment history** — Number and frequency of late payments.
- **Length of credit history** — Amount of time you've been in the credit system.
- **Homeownership** — Whether you own or rent.
- **Inquiries for credit** — Number of times you've recently applied for new accounts, including mortgage loans, utility accounts, credit card accounts, etc.
- **Number of open credit lines** — Number of major credit cards, department store credit cards, etc., that you've actually opened.
- **Type of credit in use** — Major credit cards, store credit cards, finance company loans, etc.
- **Outstanding debt** — How much you owe compared to how much credit is available to you.

## Why does the same customer get different scores from different companies?

As the use of insurance scoring becomes more prevalent, the major credit bureaus and other credit consulting companies are introducing new products into the marketplace. At the same time, many companies are developing their own models for insurance scoring. The scoring process can be viewed as a menu from which each insurance company can choose items. Although each company will have access to the same credit information, the combinations they choose will likely be different. Because of the competitive marketplace, each company wants to develop its own combination. This competition is the reason why a customer may get different scores from different insurers.

Even if an applicant gets similar scores from different companies, the companies seem to use the score in different ways. Why is that? Just as every company's underwriting guidelines and rating tools are different, insurers use insurance scores in a variety of ways. Many companies use insurance scores as one of a series of tools to better evaluate risk.

### Does a large number of credit inquiries affect a insurance score?

Inquiries or "hits" are tallied whenever a consumer's credit report is accessed for the purpose of determining the consumer's credit performance. For example, whenever an individual applies for a credit card or a home equity loan, the credit check performed is considered an inquiry. As with virtually all credit checks, applications for additional credit have an impact on insurance scores. However, most insurance companies weed out multiple hits for loan and mortgage applications and focus on long-term patterns of credit management practices. Single incidents generally have minimal impact.

## ***If a husband and wife have different scores, which one is utilized?***

Over time, a husband and wife will find their scores to be similar. However, if the scores are different, most companies will utilize the highest (most favorable) of the two.

## ***What about those who shop around for the best insurance rates? Will those insurance company inquiries create multiple “hits?”***

No. These inquiries are reflected on the credit report but are not used in developing an insurance score.

## ***What about those individuals for whom a score cannot be calculated?***

If no score can be developed, some companies ignore insurance scoring, and others assign them to a specific tier, usually better than standard. This normally means the individual does not have a recent credit history.

## ***Can a large open credit line create a bad score?***

A large available credit limit may affect an insurance score. Simply put, the whole concept of insurance scoring is about managing assets. Insurance companies assert that those who manage their financial assets well are less likely to require the use of asset protection. Insurance is asset protection. Groups of individuals who establish available amounts of credit which are extraordinarily high are statistically more apt to incur difficulties in managing their assets.

## ***What can customers do to improve their insurance scores?***

An insurance score is a snapshot of your insurance risk picture at a particular point in time. Your score changes as new information is added to your file and will improve through a pattern of responsible credit use. The following are a few tips that customers can use to improve an insurance score:

- **Pay bills on time.** Delinquent payments and collections can have a major negative impact on an insurance score.
- **Keep balances low on unsecured revolving debt like credit cards.** High outstanding debt can affect an insurance score.
- **Apply for and open new credit accounts only as needed.** Maintain the necessary minimum number of credit cards, as well as other credit accounts.
- **Close “0-balance” credit cards.** These should be closed in writing, and written confirmation should be received and retained.



- **Annually request a copy of credit report.** Review for accuracy and correct all errors in writing. Over time, responsible use of credit can increase a customer's insurance score. **(Note: New Jersey residents are entitled to one copy of their credit report a year from each of the major credit bureaus. See page 5 for more information.)**

## What are the Fair Credit Reporting Act implications?

The Fair Credit Reporting Act requires that applicants be informed about the consumer reports that were used to make decisions on their insurability. If an “adverse decision” (rejection or higher price) is made based upon an unfavorable MVR (Motor Vehicle Report), CLUE report (Comprehensive Loss Underwriting Exchange Report) and/or Insurance Score, the applicant must be given an opportunity to review the report(s) for accuracy. Consumers may request a copy of their credit report through one of the following contacts:

**Equifax**  
**(800)-685-1111**

**Experian**  
**(888)-397-3742**

**TransUnion**  
**(800)-888-4213 or (800)-916-8800**

**Note:** New Jersey residents are entitled to one copy of their credit report a year from each of the major credit bureaus. When calling about your free report, be advised that you must indicate that you are requesting a free (legislated) credit report. Respond only to prompts that are associated with a free (legislated) report or be sure to mention that you reside in New Jersey and are entitled to one free report per year.

## Are credit scores unfair to minorities?

No comprehensive data has established that insurance scores have a disparate impact on minorities. Consumers have the ability to control or improve their own rating based on their individual efforts. **The following information is not used in any insurance scoring models:**

- Ethnicity
- Income
- Religious Beliefs
- Gender
- Marital Status
- Nationality
- Age
- Address

## Know Your Credit History

There is a good chance your current or prospective insurance company is looking at your credit. Therefore, it is a good idea to review your credit history to make sure it's accurate. All New Jersey residents are entitled to one free credit report a year from each of the major credit bureaus: Equifax, Experian and TransUnion (see **Note** on this page).

If you find any errors in your credit report, report them to the credit bureau and your insurance company. You can also contact the Federal Trade Commission for consumer brochures on credit at <http://www.ftc.gov/>.

The **Fair Credit Reporting Act** requires an insurance company to tell you if they have taken an “adverse action” (rejection or higher price) against you, in whole or in part, because of your credit report information. If your company tells you that you have been adversely affected, they must also tell you the name of the national credit bureau that supplied the information so you can correct any errors.

## Summary

Classifying risks into groups with actuarially similar chance of loss characteristics is a common practice in personal lines underwriting and pricing. It permits those with a lower chance of loss to appropriately pay less for their insurance protection. Insurance scoring classifies risks according to their ability to manage finances responsibly. Insurance scores can be improved through active management of the factors that make up an individual's credit history.

If your insurance company is using your insurance score to evaluate your rates, you can take steps to improve your premiums.

- **Get a copy of your credit report and correct any errors.** Notify your insurance agent and company of any errors.
- **Improve your credit history if you've had past credit problems.** If your insurance score is causing you to pay higher premiums, ask your insurer if they will re-evaluate you when your credit improves.

## Get More Information

If you have any questions about insurance scoring or other insurance-related inquiries, contact the New Jersey Department of Banking and Insurance or visit our Web site at <http://www.njdobi.org/> for more information.

While there is evidence that demonstrates the correlation between losses and bad credit, the Department will be examining this issue as it moves forward to ensure that insurance scoring is used uniformly and never in a discriminatory fashion.



## Consumer Protections for New Jersey Policyholders

There are instances where an otherwise good credit risk will fall on hard times, affecting his or her financial responsibility and creating a spike on a credit report. Recognizing this, the New Jersey Department of Banking and Insurance is considering requiring that insurers allow for the following:

- **Death of spouse or close family member**
- **Divorce**
- **Identity theft**
- **Major illness or injury**
- **Recent loss of a job**



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